Cornell Law Review

Volume 51
Issue 1 *Fall 1965*

Article 3

Sale-of-Control Quandary

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THE SALE-OF-CONTROL QUANDARY

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Building on his custodial concept of corporate control and the resultant theory of the "contrôleur" as a strict trustee, the author endeavors to demonstrate by an analysis of three recent New York opinions that the legality of any transfer of corporate control is ultimately founded on the suitability—intellectual, moral, managerial, social, physical—of the successor "contrôleur." In reaching his conclusion the author first recognizes the legitimacy of control tenure by mere incumbency (in contradistinction to a corporate-democratic, majority-vote tenure) and then considers various indicia of "contrôleur" unsuitability which might illegitimate any transfer of control to such a "contrôleur."

The New York courts in the early 'sixties have asked the very questions most conducive to a practical body of law for the regulation of the transfer of corporate control. The answers to the problems posed in the *Essex Universal*,[1] *Caplan-Lionel*,[2] and *Republic*[3] cases should produce a set of major transfer-of-control rules, which inductively will constitute in turn a philosophy of the transfer of control.[4]

The principles implicit in the transfer of control are as important as any in the entire philosophy of control,[5] and as elusive as they are important.

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1 Essex Universal Corp. v. Yates, 305 F.2d 572 (2d Cir. 1962).

2 There are two distinct Lionel cases. The first, Caplan, was an action to set aside the election of Lionel directors. Matter of Caplan (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 24, p. 14, col. 3 (Feb. 4, 1964) (Schweitzer, J.) (reported as Matter of Lionel Corp.), aff'd sub nom. Caplan v. Lionel Corp., 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1st Dep't 1964), aff'd mem., 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877. All three courts agreed that the election was illegal. The second case, Gabriel, was a derivative action to recover for Lionel the premium received by Defiance Industries, Inc. in the transfer of control. Gabriel Indus., Inc. v. Defiance Indus., Inc. (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 119, p. 13, col. 8 (June 17, 1964) (Serafite, J.), aff'd, 23 App. Div. 2d 630, 257 N.Y.S.2d 565 (1st Dep't 1965). The plaintiff's motion for partial summary judgment was granted.

3 Matter of Carter (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 103, p. 17, col. 1 (May 26, 1964) (Korn, J.), aff'd, 21 App. Div. 2d 543, 261 N.Y.S.2d 378 (1st Dep't 1964).

4 This present article is the ad hoc application of the philosophy of the transfer of corporate control evolved in a companion study, Bayne, "The Sale of Corporate Control," 33 Fordham L. Rev. 583 (1965). Some advance in thinking since The Sale of Corporate Control will show itself in the limited area of the role of the premium. This resulted from the preparation of The Sale-of-Control Premium, scheduled for early publication. See also Andrews, "The Stockholder's Right to Equal Opportunity in the Sale of Shares," 78 Harv. L. Rev. 505 (1965); Berle, "Control in Corporate Law," 58 Colum. L. Rev. 1212 (1958); Berle, "The Price of Power—Are There New Overtones," 50 Cornell L.Q. 628 (1965); Hill, "The Sale of Controlling Shares," 70 Harv. L. Rev. 986 (1957); Javaras, "Equal Opportunity in the Sale of Controlling Shares: A Reply to Professor Andrews," 32 U. Chi. L. Rev. 420 (1965); Jennings, "Trading in Corporate Control," 44 Calif. L. Rev. 1 (1956).

5 The reasoning in both these companion articles, moreover, is essentially dependent on: Bayne, "A Philosophy of Corporate Control," 112 U. Pa. L. Rev. 22 (1963) (which has since seen some development, particularly in the matter of transfer of control); Bayne, "Corporate Control as a Strict Trustee," 53 Geo. L.J. 543 (1965). These studies provide citations to the principal commentaries in the field.

Judge Friendly, concurring in *Essex Universal*, could well have been speaking for every jurisdiction, all corporations and all stockholders: "Here we are forced to decide a question of New York law, of enormous importance to all New York corporations and their stockholders, on which there is hardly enough New York authority for a really informed prediction . . . ."[6] Judge Clark, also concurring, faced up to the present quandary of both courts and commentators.

> But particularly in view of our lack of knowledge of corporate realities and the current standards of business morality, I should . . . hope . . . the record will be generally more instructive on this important issue than it now is. I share all the doubts and questions stated by my brothers in their opinions and perhaps have some additional ones of my own. My concern is lest we may be annonncing abstract moral principles which have little validity in daily business practice . . . .[7]

The attempt here will be a resolution of "the doubts and questions" beclouding the transfer of control. The approach will be *ad hoc*, with a minimum of "abstract moral principles which have little validity in daily business practice." Since the chronological is also the logical, (I) *Essex Universal*, (II) *Caplan-Lionel*, and (III) *Republic* will be analyzed in that order. The congeries of conclusions should give a practical pattern of predictability for future transfer of control.

I

Essex Universal Corp. v. Yates

In mid-1957, Herbert J. Yates was president and chairman of Republic Pictures Corporation (predecessor in name and adversity to Republic Corporation) and owned 28.3 per cent of its voting stock. Essex Universal Corporation (controlling various diversified businesses) negotiated a contract with Yates for the sale of his interest at a price "roughly two dollars above the then market price on the Exchange"[8]—a $2,000,000-plus premium. As in *Caplan-Lionel* and *Republic*, the transfer of control was to be effected by the seriatim resignation of eight of the fourteen Republic Pictures directors.[9]

As events would have it, Yates repudiated the contract for purportedly good reason, and litigation ensued at the instance of Essex for damages for the breach.

The district court rendered summary judgment for Yates. On appeal, the court of appeals reversed. Although Yates had raised other defenses,

6 Essex Universal Corp. v. Yates, supra note 1, at 580.
7 Id. at 579-80.
8 Id. at 573.
9 Id. at 574.

the motion narrowed the issue to the one question. "Despite the disagreement evidenced by the diversity of our opinions, my brethren and I agree that such a provision does not on its face render the contract illegal and unenforceable . . . ."[10] This is the sum of the court's opinion.

The remand had a twofold purpose: to consider Yates's other defenses and to try "the question of the legality of the contested provision . . . . : [W]hether a contract for the sale of 28.3 per cent of the stock of a corporation is, under New York law, invalid as against public policy solely because it includes a clause giving the purchaser an option to require a majority of the existing directors to replace themselves, by a process of seriatim resignation with a majority designated by the purchaser."[11]

The circuit court opinion is a curious amalgam. There are in fact four opinions, the court's and three individual concurrences by Chief Judge Lumbard and Judges Clark and Friendly. About the only point of *stated* unanimity was the unqualified conclusion of per se legality—and the remand. Beyond this, a patchwork of the three will serve as the "opinion" of the Second Circuit. This synthesis of the court's "opinion" will be followed by an analysis of its major holdings.

For all their avowed differences, patient scrutiny reveals surprising accord, especially in reaching the decisive point of law. A summary syllogism will serve as an outline of the central argument of the "opinion."

The bare sale of office is illegal.
But the sale is bare only if (in violation of two postulates of "corporate democracy"):
  (1) The sale is not supported by the consent of the appropriators,[12] and
  (2) The consent of the appropriators is not gained by the vote of sufficient stock—but only a majority consent is sufficient.
But a majority is present:
  (1) Clearly with 50+ per cent stock, and
  (2) Equivalently with 28.3 per cent.
Therefore, the sale is legal.

In this reasoning all three concurred, with only minor variations.

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10 Id. at 573.

11 Ibid.

12 As the philosophy of corporate control has become increasingly more refined, the need has become correspondingly pressing for an advanced technical lexicon to meet the demand for the subtle distinctions of this complex field. Such a lexicon was submitted for general acceptance in Bayne, "The Definition of Corporate Control," 9 St. Louis U.L.J. 444 (1965). Four principal terms of art emerged from that presentation. One of these is "appropriator" —an owner who has entrusted, appropriated his asset into the custody of another. An appropriator has the continuing "right" to the control and dominion of his asset, but has ceded the actual "exercise" of that dominion. In contradistinction, an "owner" in control argot has not only the right to the dominion but has retained the exercise as well. The person, natural or legal, to whom the appropriator has entrusted his asset is the "controleur" who thereby has complete custody, but has the right to the custody only by sufferance of the appropriator. "Custody" and "appropriation" are also canonized words of art. Although the use of this technical terminology may distract at first, its utility, even necessity, will soon be apparent.

The progress of the opinion may be traced through three stages: Corporate Democracy: Consent of the Appropriators, Corporate Democracy: Majority Consent, and Majority Without a Majority.

Corporate Democracy: Consent of the Appropriators

The three judges were somewhat reluctant to declare any sale per se illegal, but New York precedents were too forthright. Chief Judge Lumbard, however, hastened to mitigate the harshness of the general rule of illegality by a qualifying definition.

> It is established beyond question under New York law that it is illegal to sell corporate office or management control by itself (that is, accompanied by no stock or insufficient stock to carry voting control). McClure v. Law . . . .[13]

On first blush this qualification seems muddled. Judge Lumbard apparently said two things: (1) the sale of control is obviously illegal without any concomitant sale of stock whatsoever, but (2) even if some stock passes, the sale is still illegal as long as that stock is not enough to carry voting control. Thus, the phrase "accompanied by no stock" seems superfluous and could mislead. "No stock" is *necessarily* "insufficient" stock to carry voting control. Thus Judge Lumbard in effect said only one thing: the sale of office is illegal if the control is unaccompanied by sufficient stock for voting control.

The exact meaning of this one statement remains partially cloudy in the early stages of the "opinion," yet it is undoubtedly the germinal statement of the central holding. In his next comment, however, Judge Lumbard, with the implicit concurrence of his confrères, moves toward the crystallization of the controlling principle underlying this first statement, and the holding. He couched this primary postulate of their principal argument in terms of corporate democracy.

> The rationale of the rule is undisputable: persons enjoying management control hold it on behalf of the corporation's stockholders, and therefore may not regard it as their own personal property to dispose of as they wish [footnote of the court]. Any other rule would violate the most fundamental principle of corporate democracy, that management must represent and be chosen by, or at least with the consent of those who own the corporation.[14]

Without noticeable adversion, Judge Lumbard has blended together two extremely important—and diametrically different—concepts: (1) it is "the most fundamental principle of corporate democracy, that management [as contrôleur] must represent . . . those who own the corporation"—"must hold . . . [control] on behalf of the corporation's

[13] Essex Universal Corp. v. Yates, 305 F.2d 572, 575 (2d Cir. 1962).
[14] Ibid.

stockholders . . . ." (2) It is also "the most fundamental principle of corporate democracy, that management [as contrôleur] must . . . be chosen by, or at least with the consent of, those who own the corporation."

The presence of the first of these principles—under the aegis of corporate democracy—increases the cloudiness of the early opinion. Strictly, corporate democracy is foreign to this first principle. Judge Lumbard, without visible objection, has stated an age-old axiom of property tenure: the custodian of another's goods is invariably accountable to the appropriator for his stewardship and must direct his entire management of the property to the benefit of the appropriator[15] and not to his own interest. Thus "management control [the contrôleur]" must "hold it on behalf of the corporation's stockholders," must "represent" the appropriators. Further, this accountability extends to the transfer of the office itself. The incumbent contrôleurs "must not regard it as their own . . . to dispose of as they wish." Management may never legally transfer control without reference to the rights and interests of the appropriators.

This elemental principle of the contrôleur's accountability to the appropriator is not mentioned again in the "opinion." To what extent it influences the holding can only be conjectured. It is, however, integral to the later analysis of this article. From this point forward the argument narrows to the second of the two so-called principles of corporate democracy. This principle is manifestly the primary postulate of the central argument.

Undoubtedly the crux of the *Essex Universal* "opinion" lies here, in the major reliance the three judges placed on this primary postulate: the contrôleur "must be chosen by, or at least with the consent of," the appropriators. This is the meaning of the initial requisite of sufficient stock to carry the vote. The stock passing at the time of the transfer must be in large enough quantity "to carry voting control." Captiously one could argue that the phrase does not signify, without more, that the *democratic* vote of the ownership is the sole determinant of the legality of the transfer. Stock ownership, plus other nondemocratic factors, could *"carry"* voting control. But the three did not mean this. To them corporate democracy meant at least that the democratic consent of the appropriators is essential to a legitimate transfer. Absent this principle and any transfer is illegal.

But thus far the three have left the meanings of "voting control" and "corporate democracy" incomplete. This voting control may be transferred only when supported by the democratic vote of a large enough

15 For the first known use of "appropriator" as a technical term, see Lepaulle, "An Outsider's Viewpoint of the Nature of Trusts," 14 Cornell L.Q. 52 (1928).

block of stock. But how much stock? Sufficient stock. How much is sufficient?

Corporate Democracy: Majority Consent

The answer to the query of sufficiency comes in the second postulate in the court's syllogism: The only sufficient appropriators' approval is a majority approval.

Judge Lumbard introduces the development of this thesis gingerly by an a fortiori statement: "Such stock voting control would incontestably belong to the owner of the majority of the voting stock . . . ."[16] Only as the three judges develop their reasoning—hence, pro tem, it must be accepted *ex arguendo*—is it certain that they posit majority ownership of the voting stock—over 50 per cent—as the chief, perhaps sole, requisite for a legitimate transfer of that control.

Presumably Judge Clark was expressing this thought when he said (citing *McClure*) that "New York law may render unlawful an agreement for the naked transfer of corporate office"[17] and Judge Lumbard later with the words: "a bare sale of office."[18] The bareness and the nakedness, therefore, consist in (1) a sale effected by anything other than the democratic consent of the appropriators, and (2) less than a majority approval of that democratic vote.

Judges Lumbard and Clark are somewhat reticent. Not so Judge Friendly.[19] He carries his notion of corporate democracy and majority stock ownership to a rigid and conservative extreme.

> Hence, I am inclined to think that if I were sitting on the New York Court of Appeals, I would hold a provision like Paragraph 6 violative of public policy save when it was entirely plain that a new election would be a mere formality—i. e., when the seller owned more than 50% of the stock.[20]

At this point the court (except Judge Friendly, as New York) is faced with a dilemma. The sale by Yates with only 28.3 per cent is legal on its face. Yet the legality of the transfer depends on the democratic vote and majority approval. What to do?

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16 Essex Universal Corp. v. Yates, supra note 13, at 575.
17 Id. at 580.
18 Id. at 577.
19 Judge Friendly will appear to be talking out of both sides of his mouth. Rather he first expressed his own reasoning and then reluctantly adhered to New York law. He showed palpable exasperation with counsel who "were primarily devoted to argument as to what the New York law has been rather than what it ought to be." Essex Universal Corp. v. Yates, 305 F.2d 572, 581 (2d Cir. 1962). Thus, Judge Friendly could find nothing illegal under New York law, and yet personally argue for illegality in the absence of 50% of the stock.
20 Essex Universal Corp. v. Yates, 305 F.2d 572, 581 (2d Cir. 1962).

Majority Without a Majority

The third of the three major propositions of the "opinion"—and a remarkable conclusion as well—lies in Judge Lumbard's resolution of the dilemma, concurred in by Judges Clark and Friendly (as New York).

> Essex was, however, contracting with Yates for the purchase of a very substantial percentage of Republic stock. If, by virtue of the voting power carried by this stock, it could have elected a majority of the board of directors, then the contract was not a simple agreement for the sale of office to one having no ownership interest in the corporation . . . . Such stock voting control would incontestably belong to the owner of a majority of the voting stock, and it is *commonly known that equivalent power usually accrues to the owner of 28.3% of the stock.* [italics added] For the purposes of this analysis, I shall assume that Essex was contracting to acquire a majority of the Republic stock, deferring consideration of the situation where, as here, only 28.3% is to be acquired.[21]

Judge Lumbard would not admit that this was a departure from his position. He thus remains true to his dual thesis of (1) control founded only in the consent of the appropriators and (2) the majority consent of those appropriators, but squeezes Yates under the fence with only 28.3 per cent by equating "a practical certainty"[22] with majority certainty.

Thus something less than fifty per cent may be tantamount to majority stock ownership and thereby satisfy the demands of corporate democracy and majority consent. Judge Clark echoes Judge Lumbard: "Surely in the normal course of events a management which has behind it 28.3 per cent of the stock has working control . . . ."[23] Judge Friendly (as New York) went a step further:

> Although Barnes v. Brown . . . dealt with the sale of a majority interest [and approved the sale], I am unable to find any real indication that the doctrine there announced has been thus limited [to "majority" instances]. True, there are New York cases saying that the sale of corporate offices is forbidden; but the New York decisions do not tell us what this means and I can find nothing . . . to indicate that New York would not apply Barnes v. Brown [and thus attribute legality] to a case where a stockholder with *much less than a majority* conditioned a sale on his causing the resignation of a majority of the directors and the election of the purchaser's nominees.[24] [Emphasis added.]

Query how much of a step further is Judge Friendly's "much less than a majority" than the "equivalent power" of Judges Lumbard and Clark. No

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21 Id. at 575.

22 Id. at 579. "If Essex was contracting to acquire what in reality would be equivalent to ownership of a majority of stock, i. e., if it would as a practical certainty have been guaranteed of the stock voting power to choose a majority of the directors of Republic in due course, there is no reason why the contract should not similarly be legal."

23 Id. at 580.

24 Id. at 582.

one of the three defines the requisites for legitimacy when less than a majority or sets the lowest limit which would still be sufficient. Nor do they explain, beyond the mere statement, why a lesser amount is tantamount to a majority. Nor most of all, do they reconcile it with a democratic consent of the appropriators.

Only the conclusion to the syllogism now remained. The group agreed on the three principal points supporting the unadorned holding of legality: the bare sale of office is illegal, but the sale is bare only if violative of the twofold stipulation of corporate democracy: (1) the voting control being transferred must be founded on the consent (and accompanied by the sale) of stock ownership (not some other basis for control) and (2) that consent of stock ownership must be a majority—over fifty per cent. But "28.3 per cent of the voting stock . . . is usually tantamount to majority control."[25] In *Essex Universal* the voting control is 28.3 per cent. The conclusion: therefore the transfer is legal.

With their principal thesis established the judges proceeded to dispose of any possible obstacles to their central holding.

The Presumption of Legality

Judge Lumbard, without comment from his associates, carried the reasoning of legality to an understandable presumption.

> Because 28.3 per cent of the voting stock of a publicly owned corporation is usually tantamount to majority control, I would place the burden of proof on this issue on Yates as the party attacking the legality of the transaction. Thus, unless on remand Yates chooses to raise the question whether the block of stock in question carried the equivalent of majority control, it is my view that the trial court should regard the contract as legal and should proceed to consider the other issues raised by the pleadings.[26]

Without any other illegalities in rebuttal, this majority-ownership presumption will prevail.

The Premium Question

The remainder of the "opinion" revolved around the possible impact of the $2,000,000 premium passing from Essex to Yates. Judge Lumbard, again without supporting comment, began with a general rule:

> There is no question of the right of a controlling shareholder under New York law normally to derive a premium from the sale of a controlling block of stock. In other words, there was no impropriety *per se* in the fact that Yates was to receive more per share than the generally prevailing market price for Republic stock.[27]

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[25] Id. at 579.
[26] Ibid.
[27] Id. at 576.

Seemingly the judge first raised and then dismissed the premium question as preliminary to the consideration of other possible irregularities which would vitiate the transfer. More likely, however, his later references to the commonplace sale-of-control frauds are exceptions to his general premium rule, that is, instances where a premium was *not* proper.

In either case, Judge Lumbard next proceeds to cases of clearly illegal sales, where the contrôleur "may be compelled to account to the corporation for that part of the consideration received by them which exceeds the fair value of the block of stock sold, as well as for the injury which they may cause to the corporation."[28] Here the judge instances the familiar looting cases, *Gerdes*[29] and *Insuranshares*.[30] In both, the court hands over the premium to all the shareholders. He mentions another possible exception, *Perlman v. Feldmann*.[31] However, here Judge Lumbard found no "illegitimate activity on the part of the purchasers."[32] The illegality lay with the sellers who "had appropriated to their personal benefit a corporate asset"[33] which belonged equally to all.

Judge Clark added two other possible illegal activities which presumably would frustrate the presumption of legality. "[T]here is no evidence at this stage that the vendor's power to transfer control of the board was to be secured unlawfully, as, for example, by bribe or duress."[34]

Judge Lumbard summarizes the premium question:

> A fair generalization from these cases may be that a holder of corporate control will not, as a fiduciary, be permitted to profit from facilitating actions on the part of the purchasers of control which are detrimental to the interests of the corporation or the remaining shareholders. There is, however, no suggestion that the transfer of control over Republic to Essex carried any such threat to the interests of the corporation or its other shareholders.[35]

Thus, absent any "profit from facilitating actions . . . detrimental" to the corporation, any premium is legitimate and does not overturn the major presumption of legality established by majority stock ownership (or its equivalent).

The two million dollar premium in *Essex*, since it did not correspond to any of the classes of illegal premiums, did not vitiate the deal.

Only Judge Friendly embarked on a theory peculiar to himself. Not only is majority ownership the sole norm of legality, but no exceptions are

28 Ibid.
29 Gerdes v. Reynolds, 28 N.Y.S.2d 622 (Sup. Ct. N.Y. County 1941).
30 Insuranshares Corp. v. Northern Fiscal Corp., 35 F. Supp. 22 (E.D. Pa. 1940).
31 219 F.2d 173 (2d Cir. 1955), reversing 129 F. Supp. 162 (D. Conn. 1952), cert. denied, 349 U.S. 952 (1955).
32 Essex Universal Corp. v. Yates, 305 F.2d 572, 576 (2d Cir. 1962).
33 Ibid.
34 Id. at 580.
35 Id. at 576.

permissible in the form of lesser percentages "equivalent to" majority ownership.:

> I have no doubt that many contracts, drawn by competent and responsible counsel, for the purchase of blocks of stock from interests thought to "control" a corporation although owning less than a majority, have contained provisions like Paragraph 6 of the contract *sub judice*. However, developments over the past decades seem to me to show that such a clause violates basic principles of corporate democracy . . . . This seems to me a wrong to the corporation and the other stockholders which the law ought not countenance, whether the selling stockholder has received a premium or not . . . .
>
> Hence, I am inclined to think that if I were sitting on the New York Court of Appeals, I would hold a provision like Paragraph 6 violative of public policy save when it was entirely plain that a new election would be a mere formality—i.e., when the seller owned more than 50% of the stock.[36]

Judge Friendly would not rely on other illegalities—looting, appropriation of corporate assets, bribery, duress—but would declare, without more, any transfer of control illegal unless the purchaser commanded over fifty per cent of the voting stock.

This is the "opinion" in *Essex Universal*. With such surprising concurrence, one would wonder why the four opinions.

What is to be said of the court's reasoning, its conclusions, and the principles implicit throughout?

Essex Universal Analyzed

By building on the four opinions, by distinguishing and refining, some new insights into the working principles underlying the transfer of control should eventuate. Certainly no dissent can be directed to the sole official act of the court. The unexplained and unqualified pronouncement of the per se legality is unassailable. (This is a dangerous statement, however, and wants expatiation.) Since the opinion itself went no further, any commentary must revolve around the three concurring opinions.

The court cleared the ground early with an oft-overlooked distinction. Wherein lies the alleged illegality? In the (1) payment of a premium, or the (2) transfer itself? At every stage of the way the "opinion" made it manifest that any—if any—illegality lay not in the bonus paid for the transfer but in the transfer of the office itself. The premium question was for granted; or for elsewhere. (But even this was not fully true of Judge Friendly, *pro per*.)

(1) *The Nature of the Sale*

Although the judges skirted the point frequently, with glimmerings here and intimations there, no forthright statement described the trans-

36 Id. at 581.

action as merely one particular type of the many methods of the transfer of corporate control. Nor did the three go the next step and reduce the transfer to the selection and appointment of a successor to the incumbent contrôleur.

Judge Lumbard seemed to credit Judge Friendly with such penetration when he alluded to Judge Friendly's pretermission of: "any contention that control could not be safely transferred to the particular purchaser . . . ."[37] Yet Judge Lumbard himself described the object of sale as personalty, not simply as the occupancy of an office. "[P]ersons enjoying management control hold it on behalf of the corporation's stockholders, and therefore may not regard it as their own personal property to dispose of as they wish."[38] This is undoubtedly a *lapsus linguae* because Judge Lumbard later expressed the true nature of the transaction when he quoted Judge Earl in *Barnes v. Brown*: " 'It was simply the mode of transferring the control of the corporation to those who by the policy of the law ought to have it . . . .' "[39] When Judge Friendly warned the shareholders that on some occasions they would "have no voice as to . . . [the contrôleur's] immediate successor,"[40] he correctly described the transfer in terms of the selection of a new man for the office.

Only the realization of the true nature of the transaction—essentially the selection and appointment of a new contrôleur—makes any sense out of the intricacies of the transfer of corporate control.

(2) *The Fiduciary Duty of the Appointment*

All three judges (Judge Clark's brevity, however, leaves much between the lines) enunciated the contrôleur's broad fiduciary duty to corporation and shareholders. But they did not specify that duty into its major objectives: (1) the erection of the best possible corporate structure; (2) the employment of the most enlightened managerial policy; (3) the selection of the most competent personnel.[41] Nor did they acknowledge (although almost) the selection of a successor as the contrôleur's chief act, albeit his last, toward fulfillment of this third subduty.

> A fair generalization from these cases may be that a holder of corporate control will not, as a fiduciary, be permitted to profit from facilitating actions on the part of the purchasers of control which are detrimental to the interests of the corporation or the remaining shareholders.[42]

Implicitly, the facilitation of "actions on the part of the purchasers of control" would include preeminently the first and chief facilitation of

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37 Id. at 573.
38 Id. at 575.
39 Id. at 577.
40 Id. at 581.
41 See Bayne, "A Philosophy of Corporate Control," supra note 5, at 43.
42 Essex Universal Corp. v. Yates, 305 F.2d 572, 576 (2d Cir. 1962).

any and every action of a purchaser, his appointment to the office. But Judge Lumbard is far from a conscious inclusion of the appointment itself among those "facilitating actions" which are regulated by the norms of the contrôleur's duty.

However, the all-important reasoning at the base of the contrôleur's broad fiduciary duty, and the nexus between that duty and its *ad hoc* application to the selection and appointment of a purchaser of the office, can be constructed, at times with difficulty, from the four opinions.

Custody—the Immediate Foundation. As amorphous as the corpus of his fiduciary duty of control may be, Judge Lumbard approaches parlously close to the rationalization of the prime essential of that duty: the custodial relationship existing between contrôleur and corporation. Here is that age-old axiom of property tenure which Judge Lumbard introduced early in his opinion, never to raise again. "[P]ersons enjoying management control hold it on behalf of the corporation's stockholders . . . ."[43] This could scarcely be called an endorsement of the custody theory of corporate control.[44] Yet the word "hold" is exactly expressive of custodial tenure. Strictly, management does not hold control. Management, as contrôleur, holds the corporation. The shareholders, as appropriators, have entrusted the entire corporation with all its assets into the custody of the contrôleur. The contrôleur, in acquiescing to this stewardship, receives and accepts absolute dominion over the entity, with all the obligations consequent on that dominion. Custody is the immediate foundation of the fiduciary duty.

Next, Judge Lumbard's phrase "on behalf of" is not only redolent of the strict trust but is again exactly expressive of the second essential—second to and flowing from the custody—of the fiduciary duty: the benefit-to-beneficiary rule: every thought, word, and action must redound to the good of corporation and shareholders. Judge Lumbard bolsters this analysis with the insistence "that management must represent . . . those who own the corporation."[45]

Ownership—the Ultimate Foundation. An important factor in the solution of the problem of *Essex* lies in the exact delineation of the manifold role of the appropriators in the transfer. Here the "opinion" had the answer in its neglected principle of property tenure: control must be founded on ownership. As the custody of the corporation is the *proximate* foundation of the contrôleur's fiduciary duty, so ownership (as the foundation of custody) is the *ultimate.*

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43 Id. at 575.
44 The custody theory of corporate control is delineated in detail in Bayne, "Corporate Control as a Strict Trustee," supra note 5.
45 Essex Universal Corp. v. Yates, supra note 42, at 575.

The contrôleur as custodian of the appropriator's property must trace any rights whatsoever back to him. The owner at the outset, by definition, possesses complete dominion of his assets. They are his to dispose of as he wishes. Only he may appropriate them into the stewardship of another. No one else may say who is to be appointed in his place. This is elemental. Once appointed, the contrôleur as steward holds the assets for and on behalf of the appropriator. Any rights in the steward flow from and are in virtue of ownership. In this sense, the contrôleur acts "on behalf of" and must "represent" the appropriator, "may not regard . . . [the control as his] own personal property to dispose of as" he wishes. Every act of the contrôleur must be in the best interests of the appropriators-stockholders.

But the owner's *exercise* of the right and duty to appoint his contrôleur ceases with the initial appointment. The very essence of the concept of control places the right—or at least the duty—of successive appointments in the incumbent contrôleur. At the heart of New York's problem is this fundamental postulate of the modern control phenomenon: the invariable separation of control from ownership. One may have custody only over *another's* assets.

Once appointed initially by ownership the *legitimate* incumbent assumes all the obligations of the office, the chief of which and the last is the appointment of his own successor if need be. The contrôleur either relinquishes dominion or performs the duties. The appropriator on his part either reasserts control (which may be morally imperative at times), if possible (and the control hypothesis thereby collapses, as does the question of the transfer, or leaves control in the hands of the contrôleur with the duty of naming a successor.

But the initial assumption may be *illegitimate.* By duress, blackmail, or duplicity, a contrôleur may wrest dominion from a helpless appropriator. However, even though this initial appropriation was forced and involuntary, the illicit contrôleur is nonetheless incumbent, has nonetheless acquiesced in the custody by his usurpation and his continued refusal to return dominion to the appropriator and hence has at least the duty, although not the right, to meet the demands of the office and choose a successor.

Thus both legitimate and illegitimate incumbents hold their office in the right of the ownership of the appropriator. Both possess the duty to appoint by virtue of the ownership. Thus control is ultimately founded on stock ownership in each and any case.

Ownership, then, is the foundation of the contrôleur's fiduciary duty, both in general, the *bonum commune* of the corporation, and specifically, pursuant to the third subduty, the naming of a successor.

The Duty to Appoint. Only implicitly, therefore, did the "opinion" subject the appointment of the contrôleur to the broad fiduciary duty of the corporate *bonum commune*. Further, it had difficulty in realizing that this third subduty of the contrôleur's fiduciary duty had a double aspect: (1) the actual right or duty to appoint, and (2) the suitability of the selection. In failing to distinguish the far-reaching results separating these two markedly distinct aspects, the court fell into the first, in logical sequence, of five major pitfalls in its path. The court virtually ignored the question of the appointee's suitability and seemingly assumed that if the incumbent contrôleur had the duty to appoint, the qualifications of his appointee were of no concern. True, the norms for both flow from the contrôleur's custody, are founded in ownership, and in this sense may be treated as one, but there the parity ends.

Bear in mind, therefore, that the court is never clear-cut in distinguishing the duty to appoint from the competency of the appointee. Any logical discussion, however, must sever these distinct concepts. The first consideration must be the duty to appoint. The suitability is for later.

At this point the argument reaches the crux. Whence the power to appoint? What is the source of the capacity to name a new contrôleur? What is the foundation for the appointment? What are the various types of power bases—legitimate and illegitimate—on which the contrôleur founds his custodial tenure?

In answering this focal question, the three judges placed their exclusive reliance on corporate democracy as the sole determinative of the legitimacy of the appointment (irrespective of the qualifications of the person named). Thereby, the court encountered the second major pitfall of the "opinion": the misconception that corporate democratic consent is the only legitimate power base for the contrôleur's position. According to the court, this legitimacy may be viewed from two aspects which come to the same thing: (1) an incumbent contrôleur whose tenure is unsupported by the consent of the appropriators-shareholders has no right to name a successor to the office of contrôleur and (2) a successor contrôleur who did not receive the approval of the appropriators is illegally appointed. In other words, to Judges Lumbard, Clark, and Friendly every transfer of control is illegal without the concomitant democratic consent of the appropriators-shareholders. Undeniably, here is the core of New York's problem and the source of "the doubts and questions" facing the courts.

No doubt motivated by strong predilections for corporate democracy, the court, especially Judge Friendly, immediately fell into the third pitfall (an understandable excess of their consent-of-ownership postulate):

not merely is consent of ownership the sole legitimate basis for control, but this consent must be majority consent.

The arguments against subjecting the contrôleur to the approval of anyone, including the appropriators, in the appointment of his successor are, however, a fortiori in the case of a majority-approval prerequisite. Since *bare* consent and *majority* consent are subject to the same frailties, they can be considered together, in conjunction with an analysis of the various sources, legitimate and illegitimate, of the contrôleur's power to control.

The Power Bases of the Custody. Judge Lumbard and the court were correct in their conviction that control is founded in ownership. But it would be ruinous to limit that foundation and the source of control solely to a democratic, majority approval by ownership. Majority consent is only the one of five such power bases.

On the rare occasions when the contrôleur has illegitimately seized control, the power base of his control position can range the gamut from subtle fraud to "duress"[46] or outright blackmail. For present purposes this type of power base has relevancy only toward a full treatment of the various methods of gaining and retaining control tenure.

The least complex and most obvious genesis of the control relation is verified when a one-hundred per cent owner entrusts the entire entity into the custody of a contrôleur. The legal formulae for such an appropriation are varied, *e.g.*, a proxy, a voting trust, a formal trust. Patently, total-ownership appropriation is thoroughly consonant with the court's double postulate of corporate democracy, not only consent but majority consent of ownership.

When the ownership distribution is less than one-hundred per cent in one person but more than fifty, the exigencies of corporate life and the need for some leadership give the seal of approval to a control position founded on simple democratic rule by majority. Here is the sole solution in the eyes of the court to the problem of the legitimacy of the contrôleur's tenure, the only licit power base.

(3) *Mere Incumbency v. Democracy*

The most notable present-day phenomenon of corporate life is the fateful junction of the wide dispersal of shares with the modern mechanics of solicitation (control of the proxy statement, corporate finances, personnel). This fortuitous combination has entrusted to management by incumbency alone an absolute and total custody of the corporation. Even a one-hundred per cent owner can give no greater dominion.

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46 Id. at 580.

Thus, incumbency control is necessarily founded on ownership. The initial accession to control may have been legitimate. The gradual and often imperceptible dispersal of shares may have occurred with the conscious or unconscious consent of the owners. Or the initial assumption may have been illegitimate. No matter, the contrôleur is nonetheless incumbent, nonetheless a custodian, and hence nonetheless burdened with the fiduciary duty to appoint a successor, in accordance with the interests of ownership, should conditions so demand.

Mere incumbency control expresses itself in an infinity of variations (thereby providing the fourth and fifth of the five power bases) stretching from: *the A.T.&T. type* in which a single appropriator never approaches more than one or two per cent ownership, to *tenuous incumbency control* in which a large (but short of fifty per cent) block founds its control position on the wide dispersal of, say, a ten to twenty per cent segment but is also faced with a sizable opposition block. Query whether any difference in kind separates these antipodal extremes. In both cases the rubber-stamp minority appropriators are fully incapacitated by the paucity of corporate information and the inability to utilize what little they get. Both factors are referable to the stock dispersal and the solicitation system.

The *Yates* control position is founded on a simple variant of just such a mere-incumbency tenure. The 28.3 per cent block formed a convenient base, true, but ultimately Yates stood or fell on his ability to write the proxy statement. Further, nothing in the facts indicates that his accession to control was illegitimate. Yates held the purse strings, the personnel, and the machinery. The dispersal of 1.5 million shares in the hands of 4,700 shareholders did the rest. Yates had acquiesced to the stewardship, whether legitimately or illegitimately.

Neither of the two major postulates, one in effect, of "corporate democracy" proposed by the court—(1) consent of ownership, and (2) majority approval—may be posited of the tenure of a mere-incumbency contrôleur. Neither in the *A.T.&T.* nor the Yates type do the appropriators have any, let alone majority, voice in corporate government, and hence in selecting a successor contrôleur. Nor, as has been seen, should they. The basic assumption in the entire philosophy of control is the total separation of ownership from control.

In short, the concepts of appropriator and contrôleur are mutually exclusive. In this marked respect Judge Lumbard and the court hedged in their implicit support of the custodial concept. Judge Lumbard never quite releases the corporation to the full dominion of the contrôleur. At the very moment that he speaks of management holding control and representing the appropriators he places control back in the hands of the appropriators—a contradiction in concepts. When the crucial time comes for the contrôleur to select a successor, the contrôleur ceases to be in control and the appropriators become the contrôleur. The incoming contrôleur must "be chosen by, or at least with the consent of, those who own the corporation."

The consent of the appropriators is, by hypothesis, the very thing the contrôleur need never seek. The essence of his obligation as the chief steward of the entity is the exercise of independent, unfettered judgment. He is the ultimate power in the policy-making hierarchy. Counsel, advice, yes. But his must be the final decision, else he is not the contrôleur. Compulsory consultation in such selection—approval or consent of the appropriator—destroys the contrôleur's dominion, is essentially repugnant to the twofold hypothesis of the control concept: that control is (1) separated from ownership and (2) the ultimate power in the corporation.

But, note well, do not confuse *consent of the appropriator* with *accountability to the appropriator.* A custodian must refer every act—especially his last and most important—to the best interests of the beneficiary, the appropriator. Incontestably control is founded on ownership and must consult the *bonum commune* of the corporation at all times. The benefit-to-beneficiary rule is the first major conclusion from the custodial concept.

The three judges sensed all this. Yet no one of them carried forward to a declaration of the legitimacy of a mere-incumbency contrôleur, and consequently of any appointment made by him. The first hedge in their stand appeared in the endeavor to mitigate the harshness of their majority-ownership rule. All three were prepared (except Judge Friendly, *pro per*) to equate "tantamount" (Judge Lumbard) and "working control" (Judge Clark) and "much less than" (Judge Friendly, as New York) with the strict fifty-plus-per-cent majority of their initial stipulation. Thus, in trying to step around the third pitfall, the strict-majority requisite—and perhaps subconsciously the second, consent of ownership—the "opinion" walked squarely into the fourth. When the basis of the approval is ownership consent, less than and "much less than" are by no means "equivalent" to fifty-plus-per-cent stock ownership. When the basis is share dispersal and the solicitation system, no ownership at all is requisite. Then, *no stock whatsoever* is "the equivalent of majority control." Only on this basis is it true to say that "it is commonly known that equivalent power usually accrues to the owner of 28.3% of the stock." The foundation for "that equivalent power" is neither the majority vote nor the consent of stock ownership, but the solicitation system and the dispersal of shares.

It matters not how much or how little stock would be "usually tantamount to majority control" or would "in the normal course of events" carry "working control" or be "much less than a majority." Thus the labored attempts to equate 28.3 per cent with a true majority were unneeded from the outset.

Ironically the three opinions are peppered with intimations that this less-than-majority control is in fact founded on mere incumbency, unrelated to any postulates of corporate democracy. Judge Clark, who had the least to say on the matter, related Yates's control to the proxy machinery: "Surely in the normal course of events a management which has behind it 28.3 per cent of the stock has working control, absent perhaps a pitched proxy battle which might unseat it."[47] Antecedent to such "pitched proxy battle" the incumbent contrôleur owes his position to the wide dispersal of shares. Until unseated, the contrôleur's dominion is absolute, even though threatened, and fully dependent on his domination of the proxy statement. The threat of a proxy fight does not minimize the contrôleur's absolutism. A successful fight merely changes one mere-incumbency contrôleur for another.

Judge Lumbard came close to a description of the mechanics of incumbency control:

> If Yates chooses to raise the issue [whether "28.3 per cent . . . is usually tantamount to majority control"], it will, on my view, be necessary for him to prove the existence of circumstances which would have prevented Essex from electing a majority of the Republic board of directors in due course. It will not be enough for Yates to raise merely hypothetical possibilities of opposition by the other Republic shareholders to Essex' assumption of management control. Rather, it will be necessary for him to show that, assuming neutrality on the part of the retiring management, there was at the time some concretely foreseeable reason why Essex' wishes would not have prevailed in shareholder voting held in due course. In other words, I would require him to show that there was at the time of the contract some other organized block of stock of sufficient size to outvote the block Essex was buying, or else some circumstance making it likely that enough of the holders of the remaining Republic stock would band together to keep Essex from control.[48]

"[A]ssuming neutrality on the part of the retiring management" is probably the key phrase in this analysis. Judge Lumbard meant that control of the solicitation carried control of the corporation. Thus if "retiring management" decided to welsh on the deal, the stock ownership of Essex and the democratic vote would come to naught. "Neutrality" must be translated "partiality" if Essex, even with the 28.3 per cent block, is to gain control. If Yates, still incumbent but without his 28.3

[47] Ibid.
[48] Id. at 579.

per cent, presents a third "management" slate in the proxy, the stock ownership and the democratic vote would avail Essex nothing even with its 28.3 per cent block.

Domination of the proxy statement, not a democratic majority or consent, makes it *un*-"likely that enough of the holders of the remaining Republic stock [the dispersed shares] would band together to keep Essex from control."

Of the three, Judge Friendly best understood that the incoming contrôleur's tenure:

> will depend not merely on the proportion of the stock held by the seller but on many other factors—whether the other stock is widely or closely held, how much of it is in "street names," what success the corporation has experienced, how far its dividend policies have satisfied its stockholders, the identity of the purchasers, the presence or absence of cumulative voting, and many others. Often, unless the seller has nearly 50% of the stock, whether he has "working control" can be determined only by an election; groups who thought they had such control have experienced unpleasant surprises in recent years.[49]

Judge Friendly acknowledged, in the face of a genuine need ("death, incapacity or other hazard may prevent a director from serving a full term"[50]), the legitimacy of some mere-incumbency appointments, when the owners "will have no voice as to . . . [the contrôleur's] immediate successor."[51] But inexplicably he would not extend legitimacy to the other commonplace mere-incumbency types, A.T.& T. and Yates.

Again, at another point, Judge Lumbard seemed to be placing the efficacy of the "equivalent power" on the mere dispersal of shares:

> Although in the case at bar only 28.3 per cent was involved, it is commonly known that a person or group owning so large a percentage of the voting stock of a corporation which, like Republic, has at least the 1,500 shareholders normally requisite to listing on the New York Stock Exchange, is almost certain to have share control as a practical matter.[52]

This is no other than *mere-incumbency* control. The central 28.3 per cent might facilitate the matter, but ultimately control is founded on the sheepishness of the remaining appropriators. With this the court rested. By concluding that 28.3 per cent was tantamount to majority, the legality of Yates's transfer to Essex was proven. The Yates defense of per se illegality thereby fell. The remand was designed ouly to confirm the fact of the equivalent power of the 28.3 per cent, and dispose of other possible defenses.

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49 Id. at 582.
50 Id. at 581.
51 Ibid.
52 Id. at 579.

At this point, however, the court should not have rested. True, Yates had a fiduciary duty to appoint his successor, not because the majority or equivalent of ownership approved in a democratic election, but because Yates through his mere-incumbency, wholly nondemocratic control had assumed custody of Republic, but this is a far cry from an unqualified approbation of the suitability of the appointee for the office. It is one thing to have the right or duty to appoint and another to select the proper man for the job.

The court undoubtedly knew this, but never carried through with a judicial inquiry into the qualifications of Essex Universal for the position of contrôleur of Republic. Perhaps this was a matter for the remand. Had Essex Universal been egregiously unqualified, certainly this would have elicited a marked adversion by the court to its suitability, in spite of the incumbent contrôleur's right to appoint it.

This present analysis of *Essex Universal,* however, demands that that inquiry into the suitability of the appointee be carried through. Judge Friendly certainly moved the reasoning to the threshold of such an inquiry. Seemingly he made the junction between the broad fiduciary duty, the *bonum commune* of the corporation, and the lesser subdivision of that duty, the selection of a successor, even though he did not advance beyond the general statement: "But the stockholders are entitled to expect that . . . the remaining directors will fill the vacancy in the exercise of their fiduciary responsibility."[53] Judge Friendly clearly recognized that the heart of the transfer was the choice of a man for the job, and that this choice must be regulated by fiducial norms.

These fiducial norms governing the selection of the successor to the contrôleur should form the foundation for any adjudication on the legality of the transfer of control.

(4) *The Proximate Norms*

The breakdown of the contrôleur's obligation in the choice of a successor into its (1) intellectual, (2) moral, (3) managerial, (4) social and (5) physical components was understandably not the deliberate concern of the court. Yet, consistent with the philosophy of the "opinion," these proximate norms of successor suitability can be partially discerned throughout. Although Judges Lumbard and Friendly were far from employing the five norms *nominatim*, they related the legality of the transfer to the character deficiencies of the appointee. Judge Lumbard referred to "circumstances of the sale [which] put them [the outgoing contrôleur] on notice of the buyers' evil intentions" and later "to persons whose

53 Id. at 581.

intentions they had reason to suspect . . . ."[54] Judge Friendly was concerned over the lack of "any consideration of the character of the latter's nominees . . . ."[55]

At this point, Judge Lumbard correctly introduced a major presumption (although he founded it on incomplete grounds):

> whenever the incumbent contrôleur bases his position on majority stock ownership, the rebuttable presumption arises that his selection of a successor has satisfied the fivefold norms of character suitability.

"I would place the burden of proof on this issue on Yates as the party attacking the legality of the transaction. . . . [T]he trial court should regard the contract as legal and proceed to consider the other issues . . . ."[56] Judge Lumbard's presumption of propriety is sound, but the foundation of the presumption on majority stock ownership alone (or stock ownership "tantamount to majority control"[57]) is incomplete. Any incumbent contrôleur, either legitimate or unchallenged illegitimate, pursuant to his duty to appoint a successor, should be accorded the same presumption. Whether the contrôleur founds his tenure on (1) majority approval; (2) total-ownership appointment, or (3) mere incumbency, the assumption should be that he is exercising good judgment in his selection until the contrary is judicially proven. This presumption, however, is rebuttable and established guidelines aid in mounting the rebuttal.

(5) *The Indicia of Breach*

Throughout their opinions Judges Lumbard and Friendly recurred regularly to certain telltale instances—they did not call them *indicia* of appointee unsuitability—where the outgoing contrôleur should have been put on notice that his choice of a man for his job was a poor one, that the selection of such a successor was either intentionally or negligently violative of his fiduciary duty. The *indicia* of a breach of the proximate norms, and the failure of the presumption of suitability, were no wise exhaustive, but they got the point across.

Predictable Spoliation. Citing *Gerdes*,[58] Judge Lumbard established the intention to loot the corporation as a prime *indicium* of an appointee's unsuitability to lead the company. "[T]he court required the sellers to account [to the corporation, for the premium] on the theory that the circumstances of the sale put them on notice of the buyers' evil intentions."[59]

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54 Id. at 576, 577.
55 Id. at 581.
56 Id. at 579.
57 Ibid.
58 Gerdes v. Reynolds, 28 N.Y.S.2d 622 (Sup. Ct. N.Y. County 1941).
59 Essex Universal Corp. v. Yates, 305 F.2d 572, 576 (2d Cir. 1962).

Self-Serving Contracts. An incoming contrôleur is suspect if his avowed or provable motives are inconsistent with the *bonum commune* of the corporation. The Wilport syndicate, incoming contrôleur in *Perlman v. Feldmann*,[60] alerted incumbent Feldmann of skullduggery by its readiness to hand over a $1.3 million premium (which the court held belonged to all equally) for the sale of control. The syndicate wanted, as the new contrôleur, to award itself steel contracts without paying the legal, although gray-market, bonus. Although Judge Lumbard saw "an absence of illegitimate activity on the part of the"[61] syndicate, either the illicit premium or the intent to pay no bonus seems to be some indication of such moral laxity as to impugn the syndicate's suitability to run the firm. But regardless of Judge Lumbard's estimate of the activity in *Feldmann*, proof of self-serving contracts should induce close scrutiny of the appointee.

Fraud and Duress. Judge Clark instanced a bald *indicium*: "[T]he vendor's power to transfer control of the board was [not] to be secured unlawfully, as, for example, by . . . duress."[62]

The Appointee's Character. Strictly, all *indicia* point to the appointee's character. But a separate category serves admirably to segregate the gross evidences, *i.e.*, fraud, looting, duress, from the less tangible, personal deficiencies, *e.g.*, a proclivity to gambling or alcohol, social, or physical ineptitude. Judge Friendly insisted on the "consideration of the character of the . . . . nominees . . . ."[63]

These *indicia*, extracted somewhat forcibly from the *Essex Universal* opinions, are at best only examples of many another sign of an unqualified appointee, and hence an illegal appointment.

The final and by far most important *indicium* demands separate consideration.

(6) *The Role of the Premium*

Judges Lumbard and Friendly were faced with a dilemma. New York law was clear. A premium was not per se improper. Yet, with varying degrees of perspicacity, both judges understood that the premium was a prime indicator of possible present and future wrongdoing, that such wrongdoing was inevitably a human activity, and that the principal human involved was the incoming contrôleur.

60 219 F.2d 173 (2d Cir. 1955), reversing 129 F. Supp. 162 (D. Conn. 1952), cert. denied, 349 U.S. 952 (1955).

61 Essex Universal Corp. v. Yates, supra note 59, at 576.

62 Id. at 580.

63 Id. at 581.

In the looting cases, *Gerdes*[64] and *Insuranshares*,[65] the court ordered the premium paid over to the corporation. Judge Lumbard was cognizant that here at least the premium was connected with the wrongdoing—and hence unsuitability—of the incoming contrôleur. "[T]he court required the sellers to account on the theory that the circumstances of the sale put them on notice of the buyers' evil intentions."[66] In such gross instances the premium is only one presage of the incoming contrôleur's future conduct. The amount of the premium figured further in Judge Lumbard's thinking.

> The court found the price paid grossly in excess of the calculable fair value of a controlling interest in the corporation, and found the differential to be payment for the immediate control which, foreseeably, the buyers used to the detriment of the corporation and its other shareholders.[67]

Judge Lumbard becomes more explicit later in his opinion:

> The payment of a large premium for resigning (alleged to be $800,000 in Benson v. Braun) is of course, relevant to the question whether the sellers had any reason for suspecting that the purchasers had improper intentions in acquiring control.[68]

Judge Lumbard not only designates the premium as an *indicium* of chicanery but relates the chicanery directly to the purchasers.

Judge Friendly was more manifest. He even seems implicitly to maintain that the premium is per se illicit. To Judge Friendly, any outgoing contrôleur, with less than fifty per cent of the stock, offends corporate democracy in denying the majority the selection of the incoming contrôleur. In inveighing against this "usurpation," he expressed his attitude toward the premium. "This seems to me a wrong to the corporation and the other stockholders which the law ought not countenance, whether the selling stockholder has received a premium or not."[69] The inference is justified that the premium is an *additional* "wrong to the corporation and the other shareholders" else why mention it as he did?

Since the premium was $2,000,000 in *Essex*—more important, a two dollar premium at six dollar market per share, an impugning ratio—these reflections of the "opinion" are explicable only as a query: why not also in *Essex*? If the premium pointed to an undesirable appointee in *Gerdes*, *Insuranshares*, *Benson v. Braun*, why not in *Essex*? Or elsewhere?

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64 Gerdes v. Reynolds, 28 N.Y.S.2d 622 (Sup. Ct. N.Y. County 1941).
65 Insuranshares Corp. v. Northern Fiscal Corp., 35 F. Supp. 22 (E.D. Pa. 1940).
66 Essex Universal Corp. v. Yates, 305 F.2d 572, 576 (2d Cir. 1962).
67 Ibid.
68 Id. at 576.
69 Id. at 581.

The answer to these queries lies in a deeper explanation of the nature and role of the premium,[70] and another influential distinction.

The Presumption of Premium Illegality. Judges Lumbard and Friendly thrashed about in their brush with the premium (they never really did come to grips with it) because they knew on the one hand that some premiums were pellucidly illegal—witness *Gerdes* and the like—yet on the other they also seemed sure that some were utterly blameless. The fact is that there are premiums and premiums. Some are bald bribes. Others may well be one buyer's estimate of a reasonable expenditure necessary to effect a purchase of a large block of stock without unduly influencing the market. The point: until the exact nature of a given premium has been laid bare, no court can proceed to an adjudication on the legality of the deal and ultimately on the suitability of the appointee.

Even without a present full analysis of the nature of the premium, this much is clear:

> Whenever corporate control is transferred, accompanied by the sale of some stock, a rebuttable presumption arises that any premium over the market value is illicit.

At the least, such a premium demands explanation. The explanation may be readily forthcoming. If so, the bonus was legitimate. But an unexplained premium justifies a conclusion of illegality.

This presumption of premium illegality should have prompted the court to exact an explanation from Essex and Yates as to the nature of their $2 million over market.

This presumption, however, must be distinguished from another, even more important, presumption. Here is the aforementioned influential distinction.

The Premium Presumption of Unsuitability. With the presumption of premium illegality unrebutted, one can only conclude to an illicit premium. Faced with premium illicity, one is forced to move another step to another presumption. The presence of an illegal premium points to possible duplicity in the deal and consequently to an unsuitable appointee. A reprehensible premium is undeniable evidence of the reprehensibility of the selection of the new contrôleur.

Judge Friendly sensed all this. To him, not only is the premium an evil in itself and an *indicium* of unsuitability, but more important it creates just such a presumption of unsuitability. Judge Friendly's premium-presumption position arose somewhat obiter in his extreme argument banning all transfers of control by an outgoing contrôleur with less than a major-

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70 Ibid.

ity-stock-ownership base. He endorsed this blanket prohibition because the crass tests of legality derived from the looting cases left undetected, when applied to the majority of cases, the subtly deficient appointee who nonetheless was legally and substantially unqualified for the office. "To hold the seller for delinquencies of the new directors only if he [the outgoing contrôleur] knew the purchaser was an intending looter is not a sufficient sanction. . . . Stronger medicines are needed—refusal to enforce"[71] the contract of sale. His baby-with-the-bath solution seemed necessary because (and here he raises, only to reject, the premium presumption of unsuitability as an alternative) "[t]he difficulties of proof are formidable even if receipt of too high a premium creates a presumption of such knowledge . . ."[72] Judge Lumbard was also well advised of the impact of the presence of a premium:

> The complaint [in Benson v. Braun], sustained earlier by the Appellate Division . . . alleged that this premium had been for the immediate transfer of control under circumstances raising a reasonable suspicion that the purchasers intended to loot the corporation.[73]

Judge Friendly's rejected alternative was the correct solution. The subliminal assumptions of Judges Lumbard and Friendly were correct: (1) Any premium over market is questionable. At least an explanation is deserved. (2) An unexplained premium leaves the deal—and the dealers —suspect.

Here was the last of the five major pitfalls confronting the *Essex* court: should this subliminal questioning of the legality of the premium be carried forward, first, to the formulation of a presumption of premium illegality, and then, secondly, on to the logical consequence, a premium presumption of appointee unsuitability? The court of course did not go quite that far.

Once assumed with Judge Friendly (or even *ex arguendo*) the suspect nature of the premium and the question inevitably arises: wherein lies the turpitude (and hence the later presumption of unsuitability)? The answer is twofold: (1) an incoming contrôleur who will pay $2,000,000 to Yates, when the money seemingly belongs to the other 71.7 percent ratably, is at least suspect, if not already convicted of wrongdoing. (At least the burden of proof lies with the payor-appointee to justify the $2 million extra. Thus a *rebuttable* presumption of illegality.) (2) Do such questionable means to gain control excite at least a suspicion of future

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71 Ibid.
72 Id. at 578.
73 Bayne, "A Philosophy of Corporate Control," 112 U. Pa. L. Rev. 22 (1963); Bayne, "Corporate Control as a Strict Trustee," 53 Geo. L.J. 543 (1965); Bayne, "The Sale of Corporate Control," 33 Fordham L. Rev. 583 (1965).

illegal activity? Is the suspicion sufficient to raise a rebuttable presumption? Thus an unrebutted presumption of an illicit premium raises in turn a rebuttable presumption of an unsuitable appointee?

This presumption of unsuitability is not only founded on the assumption of premium illegality but also on the incoming contrôleur's knowledge of that illegality. As rebuttable, the presumption will fall upon proof that a high-minded and conscientious appointee was convinced of the legality of the premium, as he might be in the light of prevailing New York law. With such proof, the original Lumbard presumption of legality would reassert itself and the matter would go forward on the simple question of the intrinsic qualifications of the contrôleur appointee, irrespective of any premium.

This is on the assumption, of course, that the other, lesser *indicia* of unsuitability had not otherwise destroyed the presumption of propriety established by the mere incumbency, legitimate or unchallenged illegitimate, of the contrôleur.

A reflective summary could take the form of a statement of the five major pitfalls which faced the Second Circuit in *Essex Universal*: (1) The distinction between the duty to appoint and the suitability of the appointee. (2) The legitimacy of an appointment by a mere-incumbency contrôleur, *i.e.*, without the consent of ownership. (3) The requirement of majority-ownership approval of the appointment. (4) The equation of "tantamount to majority" with strict majority approval. (5) The premium presumption of impropriety, based in turn on the unrebutted presumption of the illegality of the premium.

(7) *The Adjudication*

The major sale-of-control principles underlying *Essex Universal* should become more sharply limned by application in a hypothetical adjudication of the case.

The transfer of control, with a concomitant sale of more or less stock, or without any stock whatsoever, is by no means per se illegal. More to the point, in the words of Judge Lumbard, the "easy and immediate transfer of corporate control to new interests is ordinarily beneficial to the economy" and hence a highly desirable and often necessary method of installing a new person in the office.

The selection of such successor is governed by the broad fiduciary duty of control, the *bonum commune* of corporation and shareholders, and specifically by the (1) intellectual, (2) moral, (3) managerial, (4) social and (5) physical norms of appointee suitability.

Whether the incumbent contrôleur founds his tenure on (1) total-ownership appropriation, (2) fifty-plus-per-cent-ownership approval or (3) tenure by mere incumbency, a rebuttable presumption of propriety arises, *i.e.*, that the man selected conforms to the fivefold proximate norm of suitability. This stems from the tenable premise that an unchallenged officeholder is performing his duties in due course and suitably unless judicially proven otherwise. This premise would encompass his choice of a new man for his job.

This rebuttable presumption of propriety would indisputably prevail in *Essex Universal*, not because of a corporate democratic principle of majority or equivalent approval of ownership but through mere-incumbency tenure. Herbert Yates had acquiesced in the custody of Republic Pictures—and, for all the facts, seemingly legitimately—and as a steward had the right, or at worst the duty, to appoint a successor. Until shown otherwise one must therefore assume his selection of Essex Universal Corporation as the new top-policy person was for the best interests of Republic and in every way good and proper.

Toward the consideration of a possible breach of the five-part proximate norm of suitability, and the resultant rebuttal of the presumption of propriety of the selection, the facts as adduced reveal none of the lesser *indicia* of unsuitability. On remand, however, this matter would bear inquiry.

The presumption of Essex Universal's suitability for the office of contrôleur falls, however, in the face of the countervailing premium presumption. Essex Universal was prepared to pay $2 million over the current market to Yates. Such a premium requires explanation. Neither Yates nor Essex gave one. Such a premium may be perfectly legitimate, or it may be completely illegal. Whenever control is transferred, accompanied by the sale of some stock, a rebuttable presumption arises that any money over market is illegal. Until Essex justifies this premium the money belongs ratably to the other 71.7 percent of the shareholders. Such questionable means (since unexplained) to gain control consequently raise a suspicion of future illegal activity counter to the interests of the 71.7 percent, over and above the presumably dubious morality of the payment itself. Such conduct at least puts Essex Universal and Yates to the proof of (1) The legality of the premium, and (2) The suitability of the selection.

Since the record reveals an insufficient inquiry into the nature of the $2 million premium, and the damaging ratio of two dollar premium to six dollar market per share, as well as the lesser *indicia*, the district court on remand will entertain evidence to determine whether the premium in fact was to be paid as an illicit inducement to gain appointment to the office or was a licit payment to Yates, *e.g.*, as a necessary outlay to secure a large block, or further, whether Essex Universal had knowledge of the implications of the premium, or saw nothing reprehensible in following prevailing New York law *bona fide*. If the evidence satisfactorily shows that the "premium" was not a premium and that Essex Universal was acting in good conscience (in short that the presumption of premium illegality was rebutted), the premium presumption of unsuitability will also fall, the original presumption of propriety will revest, and Essex Universal will presumably, absent other reasons to the contrary, assume the office of contrôleur of Republic Pictures, or receive damages for the breach, according to the prayer. The court correspondingly will treat the $2 million according to its findings as to its true nature.

Since the transfer of corporate control with a concomitant sale of stock is not per se illegal, this defense of per se illegality cannot prevail, and the summary judgment for Yates should be reversed.

The major question on remand, therefore, is the acceptability of Essex Universal in the light of the *bonum commune* of the Republic Corporation and the fivefold specific norm of appointee suitability, whether, reiterating Judge Friendly's concern, "control could . . . be safely transferred to the particular purchaser . . . ."[74] With principal adversion, of course, to the rebuttable presumption of premium illegality and the consequent premium-presumption of appointee unsuitability.

II

Caplan-Lionel

The Lionel Corporation, long famous for toy trains and now in electronics as well, had been the subject of two successive control transfers within a seven-month period in 1963. Roy M. Cohn, later acquitted of perjury in the United Dye swindle and involved from McCarthy to Fifth Avenue Coach, controlled six of the eleven directors of Lionel with less than three per cent ownership.[75] In early 1963 Cohn agreed to a deferred sale (no delivery since Cohn had previously pledged the stock for an earlier indebtedness[76]) with an immediate transfer of control to Defiance Industries, Inc., a Muscat-Huffines-Krock enterprise. The price: $280,000 at five and one-half, the existing market.[77]

[74] Essex Universal Corp. v. Yates, 305 F.2d 572, 573 (2d Cir. 1962).
[75] Matter of Caplan (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 24, p. 14, col. 3 (Feb. 4, 1964).
[76] Ibid.
[77] Ibid.

Seven months later almost to the day, the late A. N. Sonnabend made a similar deal in turn with Defiance, first at $350,000[78] but eventually $415,000,[79] edged up by the inexplicably same Defiance contract with Gabriel Industries, Inc. at $425,000[80] (breached, with Sonnabend's indemnification[81]). Again, the seriatim resignation of the six control directors of Lionel.[82]

Two relevant agreements provided that Sonnabend would cause Lionel to employ three Muscat men for five years at $5,000 per year,[83] and that Lionel would acquire several Sonnabend companies (*e.g., Mad*, a doll manufacturer) in exchange for so much Lionel stock as to increase Sonnabend's holdings to thirty per cent.[84] The control transfer was again immediate, but the Cohn stock remained in pledge.[85]

Two separate actions were instituted in the supreme court. The first at the instance of Hyman Caplan[86] sought to set aside the election of the Sonnabend directors as illegal under the New York Business Corporation Law. Gabriel Industries on the second hand (undoubtedly miffed by its loss of the battle) brought a derivative action[87] to force Defiance to hand over the $135,000 premium-differential to Lionel.

In the Caplan action, special term opened its argument with the conclusion that it was "illegal to sell corporate office or management control by itself (that is, accompanied by no stock or insufficient stock to carry voting control)"[88]—a direct quotation of the opening argument in *Essex Universal*, again citing the famous *McClure v. Law*.[89] This central, unqualified holding the appellate division affirmed: "Special Term found the elections to be illegal and vacated them. With this finding and disposition we are in accord."[90] The Court of Appeals affirmed without opinion.[91]

In the Gabriel Industries suit special term built on the illegality of the election as established in *Caplan-Lionel* and concluded: "Therefore,

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78 Ibid.
79 Ibid.
80 Ibid.
81 Ibid.
82 Ibid.
83 Id. at cols. 3-4.
84 Id. at col. 4.
85 Ibid.
86 Matter of Caplan (Sup. Ct. N.Y. County) in 151 N.Y.L.J. No. 24, p. 14, col. 3 (Feb. 4, 1964).
87 Gabriel Indus., Inc. v. Defiance Indus., Inc. (Sup. Ct. N.Y. County 1964), in 151 N.Y.L.J. No. 119, p. 13, col. 8 (June 17, 1964).
88 Matter of Caplan, supra note 86.
89 161 N.Y. 78, 55 N.E. 388 (1899).
90 Caplan v. Lionel Corp., 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1st Dep't 1964).
91 Caplan v. Lionel Corp., 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964).

Defiance, who controlled the management of Lionel, when it illegally sold such control, must account to Lionel in this action for the illegal profit."[92]

Caplan-Lionel Analyzed

The reasoning and philosophy underlying the *Caplan-Lionel* litigation complement admirably the analysis of *Essex Universal*, and confirm the synthesis of *The Sale of Corporate Control*.[93] The variations in the *Caplan* facts elicit questions—and answers—exactly apropos to a fuller and deeper corpus of transfer-of-control law.

Repetition of facts and law already laid out in *Essex* would be otiose. *Caplan* builds on the framework of *Essex* and is beset for the most part with the same pitfalls as *Essex*. The approach, therefore, will be a highlight of the differences—improvements or retrogressions—in three notable areas where *Caplan* departs from *Essex*: Mere Incumbency v. Democracy, The Proximate Norms of Suitability, and The Role of the Premium.

(1) *Mere Incumbency v. Democracy*

The conclusion is irresistible that the *Caplan* court first had a deep visceral sense that the Muscat syndicate breached their fiduciary duty in appointing Sonnabend and then sought diligently for a rationalization for ousting him from control. This rationalization is the major departure from *Essex* and the undoubted center and foundation of the court's holding. In the spirit of *Essex*, *Caplan* warmly espoused corporate democracy as the family-doctor specific for any ills and maladies in the transfer of control. But, departing *Essex*, *Caplan* refused to water democracy down by equating "practical voting power"[94] with "a mathematical majority stock interest."[95] *Caplan* did not delude itself that the control held by a 28.3 per cent block was referable to ownership consent, democratic approval, or, least of all, to the strict majority consent of ownership. The *Caplan* court was vividly conscious—even more so than was Judge Friendly—that the 28.3 per cent control position of Yates, and a fortiori the three-per-cent position of the Muscat group, were attributable to the nondemocratic power of mere incumbency—the broad dispersal of shares and the solicitation system.

The *Caplan* court approached its rationalization with a seemingly wholehearted endorsement of the *Essex* concept of corporate democracy. *Caplan* began, as *Essex* began, by conditioning the legitimacy of the transfer on the democratic approval of the appropriators:

92 Gabriel Industries, Inc. v. Defiance Industries, Inc., supra note 87, at col. 8.
93 Bayne, "The Sale of Corporate Control," 33 Fordham L. Rev. 583 (1965).
94 Matter of Caplan (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 24, p. 14, cols. 3-4 (Feb. 4, 1964).
95 Ibid.

"[It] is illegal to sell corporate office or management control by itself (that is, accompanied by no stock or insufficient stock to carry voting control)" (Essex Universal . . .).[96]

In *Caplan*, as in *Essex*, the court hastened to qualify. In an "actual transfer of a mathematical majority stock interest . . . or even a lesser interest that constitutes effective voting control of the corporation (see Essex Universal . . . involving 28.3%) it has been held that such transfer is not per se illegal."[97] Here, apparently, was the same old *Essex* syllogism:

It is illegal to sell corporate office without sufficient appropriator approval.
But: A mathematical majority is sufficient appropriator approval.
And: A lesser interest constituting effective control is also sufficient appropriator approval.

The syllogism concluded, as it did in *Essex*:

In the latter [*Essex*] case, it was recognized that the block of stock involved [28.3 per cent] carried with it the practical voting power to elect a majority of the board.[98]

On first face, *Caplan* is subscribing to the *Essex* thesis that a democratic majority is latent in "a lesser interest" than a full fifty per cent, that this 28.3 per cent satisfies the requirements of corporate democracy and majority-ownership approval as long as it carries "with it the practical voting power to elect a majority of the board."[99]

But such an interpretation of *Caplan* is unfounded. *Caplan* undoubtedly was attempting to preserve stare decisis by lip service to this majority without a majority. Faced with the hard fact that the Muscat three per cent also "carried with it the practical voting power to elect a majority of the board"[100] *Caplan* made no further reference to this initial equation of 28.3 per cent with "a mathematical majority stock interest."[101]

Ignoring thenceforward this embarrassing parallel, the court introduced its own particular resolution of the case, leaving no doubt about its total allegiance to unmitigated corporate democracy and appropriator approval.

Underlying the development of such law has been an expanding judicial awareness of the importance of preserving to the body politic of a corporation, the stockholders, their legal franchise, so vital in any realm of democracy, to elect representatives of their choosing.[102]

96 Ibid.
97 Ibid.
98 Ibid.
99 Ibid.
100 Ibid.
101 Ibid.
102 Ibid.

In support of this broad philosophy *Caplan*, by direct quotation from *Essex*, adduced the same two unrelated principles of "corporate democracy": (1) the contrôleur must act "on behalf of" and "represent" the corporation and the stockholders, and (2) the contrôleur must "be chosen by, or at least with the consent of, those who own the corporation."[103] *Caplan*, as *Essex*, made no adversion to the custodial relation, as the foundation of the contrôleur's fiduciary duty, inchoate in this statement. *Caplan* merely concluded that "these fundamental principles of corporate democracy . . . dictate that the resignation of the Defiance directors and their replacement with the designees of Sonnabend . . . were, under the circumstances herein, illegal in this case."[104] Without hedging or qualifying, *Caplan* based the legitimacy—here the illegitimacy—of the Sonnabend appointment solely on the grounds of corporate democracy and strict majority-ownership approval, without the dilution of an "equivalent" power.

Caplan did make a fainthearted attempt to distinguish *Essex* by noting the absence of an actual stock transfer. But *Caplan* knew too well that the facts in *Caplan* were on all fours with the facts in *Essex*. Hence the court's conclusion constituted an implicit, if not explicit, repudiation of the *Essex* "majority without a majority."

> Even assuming that some sale or transfer of such stock could be imputed in the transaction, certainly this 3 per cent of the stock cannot be considered as carrying with it the power to elect management of the corporation.[105]

Which, of course, could be said similarly of the 28.3 per cent in *Essex*.

To its credit, the *Caplan* court, once embarked on the corporate-democracy premise, was perfectly logical in its conclusion. When control is based strictly on a democratic vote, nothing less than fifty-plus per cent can "be considered as carrying with it the power to elect management of the corporation."

An interesting obiter. Both the *Caplan* and *Essex* courts reached the correct conclusion, but for the wrong reasons. *Essex* knew that the appointment of Essex Universal as contrôleur was not per se illegal, but it also knew that the suspicious $2,000,000 premium called for further inquiry on remand. *Essex* also espoused majority-ownership corporate democracy. But bald application of corporate democracy would invalidate the Essex Universal appointment. So *Essex* hedged and called the 28.3 per cent "equivalent" to a majority. Thus the appointment was not per se illegal. The defense of illegality failed. Hence a remand.

103 Essex Universal Corp. v. Yates, 305 F.2d 572, 575 (2d Cir. 1962).
104 Matter of Caplan (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 24, p. 14, cols. 3-5 (Feb. 4, 1964).
105 Id. at col. 5.

Caplan concluded that the selection of Sonnabend was improper. Here the bald application of corporate democracy—without reference to a "majority without a majority"—rendered the contract illegal. This made it simple for the *Caplan* court.

Yet the *Caplan* court had more than a suspicion that the democratic-majority approval was not the sole legitimate foundation for control tenure. It felt in its bones that the real reason for Sonnabend's unsuitability was otherwise.

Mere-incumbency Control. The discussion of control tenure by mere incumbency began with a statement that might well have been the keynote of this entire study:

> The then prime concern of the court becomes an aspect of the corporate democratic process which has not yet been fully explored by judicial determination or regulatory provision, that of control of the mechanics and machinery of proxy solicitation and the corporate funds utilized therefor by the present incumbents of the board of directors.[106]

The entire *Caplan* opinion is shot through with the realization that control by mere incumbency is completely nondemocratic and founded on the dispersal of shares and the solicitation system.

The court first tipped its hand with a quotation from Judge Friendly, the quotation in which he warned that stockholders would occasionally "have no voice as to [the contrôleur's] . . . immediate successor."[107] In this statement Judge Friendly related the choice to the contrôleur's fiduciary responsibility.

Further, the *Caplan* court knew well that the Muscat group related its control to mere incumbency alone, had in fact "the power to elect management of the corporation" without reliance on any stock ownership at all. The detailed discussion of the mechanics of mere-incumbency control make this clear:

> The court is cognizant of the fact that the content and method of distribution of the proxy material is subject to the regulation and control of the Securities and Exchange Commission . . . . Within such limits, there is no doubt that full disclosure . . . will be required to be made of all the pertinent and relevant factors with respect to the contemplated action to be taken . . . . But such rules and regnlations still leave with present management the physical modus operandi of such solicitation and the corporate funds necessary to operate it.[108]

Query why *Caplan* did not carry this realization forward to the legitimacy of mere-incumbency tenure. Why not the same respect and recognition —granted the present corporate dispensation—accorded majority-owner-

106 Id. at col. 6.
107 Essex Universal Corp. v. Yates, supra note 103, at 581.
108 Matter of Caplan, supra note 104, at col. 6.

ship control or control founded on total-ownership appropriation. The *reductio ad absurdum* would seem to illegitimate any transfer of control of A.T. & T., U.S. Steel, or General Motors.

The System Impugned. Probably the most revealing insight lay in the attack on the present-day, nondemocratic system of contrôleur selection. At no time did the court state directly that the A.T.&T.-type, mere-incumbency tenure was per se illegal. But it effectively disavowed the system—and the tenure in consequence—by categorically blocking its operation at the crucial point in *Caplan.* Its reason:

> The solicitation material will undoubtedly propose the election of a slate perpetuating in office the very directors whom [sic] this court has held were illegally elected.[109]

Clearly an "election" by the shareholders would rubber-stamp the same Sonnabend board already appointed by the seriatim resignation of the Muscat group. Painfully *Caplan* saw no democracy whatsoever in such an election.

Frustrated, the court attempted to emasculate the mere-incumbency formula by refusing to permit the submission of the matter to the shareholders.

> [S]ome restrictions on the present board are required, so that the Sonnabend group may not take advantage of the position they hold. They shall be restricted to current management problems . . . and . . . they shall not be permitted to use their present offices as the means to secure stockholder approval for the designated directorial slate . . . .[110]

The court was convinced that:

> the interests of all of the corporate body politic require that some method be evolved so that the holders of the other 97 per cent of the corporate stock be given an opportunity to express and disseminate their views and suggestions and take whatever appropriate action they wish to with respect to both the future management of the corporation and the acquisition proposals which are about to be submitted to them.[111]

Once committed to this inherent distrust of the system, *Caplan* shifted about uncertainly.

> In other words, what is called for is some neutralizing element which will see to it that no undue advantage is arrogated to it by the current group and that other groups, which may form, will have an opportunity to take such action in the premises as they deem advisable.[112]

But the court could come forward with no substitute, no solution to the present-day corporate predicament which would permit corporate democ-

109 Ibid.
110 Ibid.
111 Ibid.
112 Ibid.

racy to operate successfully in the face of the wide dispersal of shares and the solicitation system. So it determined pragmatically on a referee who would "perform such acts as may be necessary to effectuate the decision of the court."[113] The referee forbade incumbent management to use corporate funds, personnel, and solicitation materials, to propose a slate of directors, or in any way to engage in the customary management activities toward the election of a new board.

All this, however, did not lead the court to an approbation of the non-democratic selection of the contrôleur by incumbent management. *Caplan* was loath to admit that the heart of the matter was the suitability of the appointee, not—at least here—the right to make the appointment.

Yet much in the opinion points to a suspicion that the ultimate question was the suitability of the selectee.

(2) *The Proximate Norms of Suitability*

Again the *Caplan* court was perfectly logical. Once it subscribed to the strict majority-ownership premise, further discussion was superfluous. The three-per-cent holding of Sonnabend—or even the 28.3 of *Essex*—was far from "sufficient stock to carry voting control." The conclusion was foregone—the Sonnabend appointment was illegal. Without the right to appoint, there is no need to consider suitability. "The calibre of the particular designees of Sonnabend . . . is irrelevant to the issue presented here."[114]

As final and conclusive as this was, the court nonetheless proceeded to a general discussion of suitability.

> The three directors of Lionel who remained on the Board during successive changeovers to Defiance and then to the Sonnabend group stated categorically that they believed that the Sonnabend management was not only able but necessary for the survival of Lionel . . . .[115]

Had the *Caplan* court reasoned to suitability as the key question, undoubtedly it would have moved from this broad statement to the five elements adduced earlier in this study. *Caplan*, however, was consistent to the end.

> It may well be that such individuals are well qualified to act and serve the best interests of the corporation. This court need not pass judgment thereon. The trouble is that the method by which they assumed office effectively disenfranchised the holders of the other 97 per cent of the outstanding stock of the corporation, contrary to law. In no sense can this disregard of the rights of stockholders be justified by the rectitude of the illegally elected directors.[116]

113 Ibid.
114 Id. at col. 5.
115 Ibid.
116 Ibid.

(3) *Indicia of Breach*

Seemingly the court thus concedes the moral "rectitude of the illegally elected directors" but elsewhere appear three distinct indications of the possible unacceptability of Sonnabend.

Self-Serving Contracts. When the chips were down, the court was not too sure of the Sonnabend group.

> Therefore, some restrictions of the present Board are required, so that the Sonnabend group may not take advantage of the position they hold. They shall be restricted to current management problems and other matters necessary for the proper functioning of the corporation and they shall not be permitted to use their present offices as the means to secure stockholder approval for their designated directorial slate, or dealing [sic] in matters involving self interest, such as proposed acquisitions from [Sonnabend's] Premier Corporation of America.[117]

These Sonnabend deals parallel the self-serving steel contracts of the Wilport syndicate in *Perlman v. Feldmann*.[118] Any acquisitions increasing the Sonnabend holdings from three to thirty per cent suggest close scrutiny by the court.

Unjustified Salaries and Fees. In "matters involving self interest" the court might well have included the $75,000 payable by Lionel to the departing Muscat group. These salaries may have been justifiable but certainly warrant inquiry on the trial level.

The third *indicium*, the $135,000 premium (beyond the $75,000 salaries), deserved and received considerable attention throughout.

(4) *The Role of the Premium*

Only a prejudiced reading could ascribe to *Caplan* insights superior to *Essex* in an understanding of the role of the premium. At best the *Caplan* court had a lurking sense that various premiums had various implications. That some were the expected saving in the purchase of a large block of stock. That other premiums were outright bribes. That many variants lay between markup and bribe. Conceivably Justice Korn envisaged such a reasonable bonus when he remarked: "[C]ontrol stock may command a price in excess of that payable for other shares of the corporation . . . ."[119]

Further reading reveals that this undefined and unspecified bonus is apparently altogether different from another kind of premium which must "be returned to the corporation. . . ." This premium is illegitimate. The court specifies two kinds: (1) that premium paid to "control-

117 Id. at col. 6.

118 219 F.2d 173, 176 (2d Cir. 1955).

119 Matter of Caplan (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 24, p. 14, cols. 3-4 (Feb. 4, 1964).

ling stockholders" who are "transferring office to persons who are known or should be known as intending to raid the corporate treasury or otherwise improperly benefit themselves . . . ."[120] and (2) that "bonus or premium specifically in consideration of their agreement to resign and install the designees of the purchaser of their stock, above and beyond the price premium normally attributable to the control stock being sold . . . ."[121]

This latter instance is fundamentally indistinguishable from Judge Lumbard's "bare sale of office"[122] and Judge Clark's "naked transfer of corporate office."[123]

> Nevertheless, successive contracts to assign this agreement for $350,000 and $425,000 and the ultimate sale for $415,000 clearly establish that the premium price was being paid for the accompanying transfer of managerial control that was the all important emolument of the transaction. In fact, what occurred here was the mere sale and purchase of naked directorial control, without any accompanying sale or transfer of control stock, in violation of the clear mandate of McClure v. Law . . . .[124]

The court does not spell out the differences among the classes, good and bad, of *Caplan* premiums. Nevertheless in the latter class "any bonus received for such transfer of their office [must] be returned to the corporation . . . ."[125]

In spite of repeated recurrence to the differences among premiums, one cannot be sure how fully the court appreciated them. It first accepts the general legitimacy of one class of premium, undoubtedly in deference to New York law. But later it recognizes the premium—and here who can say what kind of premium is involved, or all kinds?—as an *indicium* of wrong, by quoting Judge Friendly. " 'This seems to me a wrong to the corporation and the other stockholders which the law ought not countenance, whether the selling stockholder has received a premium or not.' "[126] Again the court returned to the illegitimacy of the premium, ("Clearly, such power alone was the commodity here being bartered to the highest bidder in the market place"[127]) but never did the court carry through to the logical implications of the illegality of a premium.

As with *Essex*, the *Caplan* court never faced up to the premium issue at all. Just when it seemed that the court was going to ascribe "such trans-

120 Ibid.
121 Ibid.
122 Essex Universal Corp. v. Yates, 305 F.2d 572, 577 (2d Cir. 1962).
123 Id. at 580.
124 Matter of Caplan, supra note 119, at col. 5.
125 Id. at col. 4.
126 Ibid.
127 Id. at col. 5.

gressions" (which is what the various premium deals were called) to the appointee and conclude to his unsuitability, the matter was dropped.

Only from the biased viewpoint of the *Essex* analysis can one maintain that the *Caplan* court had an inkling "that the premium price . . . being paid for the accompanying transfer"[128] was in cold fact its major reason for the illegality of the election of the Sonnabend designees. Rather, the decision was founded on the philosophy of corporate democracy and the denial of the franchise to the appropriators.

(5) *The Adjudication*

The Muscat control position has been unchallenged and nothing indicates that it was wrested by duress, fraud, or other illegal means from Cohn. This tenure is founded on mere incumbency—share dispersal and domination of the proxy statement—and in no way on majority ownership or democratic approval. Since such *A.T.&T.*-type control is not per se illegal, the right and duty to appoint a successor vests in the incumbent contrôleur.

On the premise that an officeholder is performing properly until proven otherwise, a presumption of the propriety of the Sonnabend appointment by Muscat immediately arises. Shareholder Caplan, therefore, as the attacking dissident, must show the nnsuitability of Sonnabend in the light of the fivefold norm.

Toward this end Caplan adduced the $135,000 premium that Somiabend was prepared to pay wholly to the Muscat men rather than prorate it over the other ninety-seven per cent of the owners. This payment raises on its part a countervailing presumption (rebuttable, true, but at least demanding an explanation) of illegality. As unexplained (and the facts presage slight success at explanation) the illegal premium induces in turn a presumption of impropriety in the appointment which adequately destroys the incumbency presumption of propriety and concludes to appointee suitability.

Two lesser *indicia* of Sonnabend unacceptability were advanced by Caplan. Sonnabend had already committed Lionel to $75,000 (over the $135,000 premium) for future Muscat consultative services. Sonnabend had further committed Lionel to purchase several Sonnabend companies with Lionel stock, thereby increasing his holdings from three to thirty per cent.

The presence of the major prenrium presumption and the two lesser *indicia* of unsuitability throws the burden back on Sonnabend. The pre-

128 Ibid.

sumption at this point: Sonnabend does not have the best interests of Lionel at heart and is unfit for the complete custody of the company.

Sonnabend should have been given full opportunity to explain. Conceivably he was genuinely convinced—as New York law has been—that the $135,000 truly belonged to Muscat alone and not to the ninety-seven per cent. Possibly it really did. Sonnabend could possibly establish the legitimacy of (a) the salaries and (b) the corporate acquisitions. With this, his general desirability would seem to be proven, barring any further character deficiencies.

On the assumption, however, that all relevant evidence has been before the court, Sonnabend's unsuitability for the office has been established. He and his designees must be removed and the $135,000 premium restored to Lionel (as it was in fact in the *Gabriel-Lionel*[129] litigation) on the tenable assumption that the premium was far out of line as a justified bonus for a large (three per cent?) block of stock.

The parallel of *Caplan* with *Essex* is almost perfect. On remand in *Essex*, Essex Universal faced the necessity of rebutting the presumptions established by the $2 million premium. Essex Universal, however, did not face any further *indicia* of unsuitability. Since 28.3 and three per cent differ neither practically (except for a bigger solicitation base) nor theoretically, the only distinction between *Caplan* and *Essex* is the absence of the two lesser *indicia* of unsuitability. Assuming the failure of Essex Universal and Sonnabend to rebut the premium presumption, the result is the same in both cases.

The holding in *Caplan* should be founded on the reasouing of the hypothetical adjudication of *Essex Universal v. Yates*.

III

Republic

Juxtaposed against *Caplan-Lionel* is another Muscat venture. This time however, at least at special term and in appellate division,[130] the Muscateers drew blood.

The parallel with *Lionel*, with one alleged and one patent exception, is pat. In early 1963 the elder William Zeckendorf controlled six of the eleven directors of the Republic Corporation (the onetime Republic Pictures [of *Essex Universal v. Yates*] now diversified into appliances) with slightly less than ten per cent of the common.[131] In July 1963, the

129 Gabriel Industries, Inc. v. Defiance Industries, Inc. (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 119, p. 13, col. 8 (June 17, 1964).

130 Matter of Carter (Sup. Ct. N.Y. County), in 151 N.Y.L.J. No. 103, p. 17, col. 1 (May 26, 1964), aff'd, 21 App. Div. 2d 543, 251 N.Y.S.2d 378 (1st Dep't 1964).

131 Id. at col. 1.

B.S.F. Corporation (an investment company controlled by the Muscat-Huffines-Krock Defiance Industries, Inc.)[132] agreed to buy the Zeckendorf interests.[133] The result: the seriatim substitution of six B.S.F. nominees. On the day following, B.S.F. paid the market price and took delivery.[134]

Victor M. Carter, the theretofore president of Republic and owner of nearly five per cent of the common, initiated action in the supreme court. Relying fully on *Caplan-Lionel*, he sought to set aside the election as illegal "since it did not take place in connection with the sale of either a majority of the stock of Republic or of such a percentage as gives working control . . . ."[135]

Full in the face of *Caplan*, special term sustained the legality of the election "in view of the vastly different facts involved . . . ."[136] The fact that was "vastly different" was the actual transferral of the stock in *Republic*. In *Caplan* the Cohn control package remained in pledge. Special term quoted *Caplan*, appellate division:

> "The underlying principle is that the management of a corporation is not the subject of trade *and cannot be bought apart from actual stock control* . . . . Where there *has been a transfer* of the majority of the stock or even such percentage as gives *working control*, a change of directors by resignation and filling of vacancies is proper (Citations omitted)" (Emphasis added).[137]

Special term did note, moreover, that in *Caplan* "the price paid was one and one-half times the market value of the stock . . . ."[138] "Here, the purchase price was substantially the same as the market price; there was no premium paid for control . . . ."[139] The court also pointed out that B.S.F. had later purchased sufficient Republic stock to hold approximately twelve per cent of the outstanding common.[140]

Republic Analyzed

When considered within the pattern of *Essex Universal* and *Caplan*, the *Republic* case is readily intelligible and not outstandingly distinctive, but nonetheless does offer another context for the expansion and deeper understanding of the law of corporate control.

Unnecessarily fearful of the obvious parallel with *Essex Universal* and

132 Brown, "What's in It for Eddie, Bob, and Vic?" Fortune, Sept. 1964, p. 139.
133 Matter of Carter, supra note 130 at col. 1.
134 Ibid.
135 Ibid.
136 Id. at col. 2.
137 Ibid.
138 Id. at col. 3.
139 Ibid.
140 Ibid.

Caplan, the *Republic* court, by Justice Korn, sought refuge in an immaterial distinction. Throughout the opinion, Justice Korn referred to the fact that "[A]t no time, from the inception of the Cohn transaction to the present was there any actual sale or transfer by Cohn of his Lionel stock. . . ."[141] The court seemingly felt that the legitimacy of the transfer of control hung on the physical "delivery of the 237,698 shares of stock."[142] Whether the stock is placed in escrow, in a voting trust, subject to a pledge agreement, or handed over at the time of the appointment of a successor contrôleur, would seem, without more, to have no relevancy to the effectiveness of the transfer of control or its legitimacy.

In spite of the labored "actual transfer" distinction, a reading of the *Republic* opinion leads one to believe that the court in fact placed the true bases for its holding elsewhere. The following analysis will proceed on this assumption.

Although the *Republic* holding faced most of the problems of *Essex Universal* and *Caplan*, two major pitfalls lay in the court's path: the failure to distinguish (1) the right to appoint from the suitability of the appointee, and (2) corporate democratic from mere-incumbency tenure.

(1) *Corporate Democracy v. Mere Incumbency*

With *Republic* thus distinguished from *Caplan* on "the vastly different facts" of an actual transfer of stock, the *Republic* court proceeded to treat the *Caplan* reasoning as if this distinction was not pertinent, which, of course, it was not. To his later chagrin, Justice Korn then embraced fully the control philosophy underlying the *Caplan* holding.

> As noted earlier, Mr. Justice Steuer stated . . . [In *Caplan*, Appellate Division] that a change of directors by resignation and filling of vacancies *is proper* where there has been either 1) a *transfer* of the majority of the stock, or 2) a *transfer* of such a percentage of stock as gives working control . . . .[143]

Here exactly is the lineal descendant of the original *Essex Universal* syllogism, repeated in *Caplan*, which so succinctly expressed the corporate democratic principles of those two cases.

Although the terminology has been diluted—nowhere in the opinion do the words "corporate democracy" appear—and the sharp lines of the philosophy have been somewhat blurred, the *Republic* opinion has in effect merely paraphrased those controlling words of Judge Lumbard, exactly expressive of the *Essex Universal* philosophy:

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141 Id. at col. 1.
142 Id. at col. 3.
143 Ibid.

> Such stock voting control would incontestably belong to the owner of a majority of the voting stock, and it is commonly known that equivalent power usually accrues to the owner of 28.3% of the stock.[144]

At no point does the *Republic* court openly postulate a fifty-plus-per-cent majority ownership as the sole requisite for the legitimacy of the control transfer, but the postulate was there, with the same implicit assertion that less than fifty per cent may still "be equivalent to ownership of a majority of the stock . . . ."[145]

> The dual requisites of the Caplan rule, namely, 1) a transfer of 2) majority or working control were both lacking in that case, but have both been satisfied in the case presently before this court.[146]

Not only did Justice Korn demand the democratic approval of a fifty-plus-per-cent majority—or what "is usually tantamount to majority"[147] approval—but he was convinced that his demand was met.

(2) *Majority Without a Majority*

But how? The *Republic* court faced exactly the same problem of reconciliation as did the Second Circuit in *Essex Universal.* Here the percentage was 9.7; there it was 28.3. In neither case could legal legerdemain transform 28.3 or 9.7 into a fifty-plus democratic majority. The answer: the strategem of Judges Lumbard and Clark in *Essex Universal.* "Here, there was a transfer of a block of stock which had historically, since 1961, carried with it actual control of Republic corporation."[148] (Since Republic Pictures Corporation of *Essex Universal* was the legitimate progenitor of Republic Corporation, Justice Korn could have carried his history back even further, since less than fifty per cent carried actual control in the days of Mr. Yates and his transfer of control to Essex Universal.) The *Republic* court expatiated on the point:

> The subject block of stock carried with it control of the corporation when Carter held it in 1961, and it carried with it control when sold by him to the America Corporation, and each successive transfer of this block of stock thereafter carried with it the requisite "working control." It cannot hereon be urged, therefore, without any historical or factual basis, that such block of stock, which has now been increased to 12 per cent, does not constitute working or actual stock control.[149]

At this point, the absence of an actual transfer in *Caplan* becomes a helpful distinction, because Justice Korn was conscious that 9.7 per cent

144 Essex Universal Corp. v. Yates, 305 F.2d 572, 575 (2d Cir. 1962).
145 Id. at 579.
146 Matter of Carter (Sup. Ct. N.Y. County) in 151 N.Y.L.J. No. 103, p. 17, cols. 1, 3 (May 26, 1964).
147 Essex Universal Corp. v. Yates, supra note 144, at 579.
148 Matter of Carter, supra note 146.
149 Ibid.

—or even twelve per cent—was distinguishable only with difficulty from the three per cent of *Caplan.* Justice Korn was further aware that everything he said about the history of control of the Republic Corporation could be said equally of Lionel. Before the Muscat-controlled Defiance Industries sold control to Mr. Sonnabend, Roy Cohn in turn held only the minimal three per cent. Thus in all three cases, *Essex Universal, Caplan, Republic,* the percentages—28.3, three, 9.7, or twelve—were reducibly and effectively identical.

The *Republic* court, then, faced a dilemma: follow the *Caplan* reasoning, since 9.7 was parlously close to three per cent, and declare the transfer illegitimate as repugnant to corporate democracy. Or, on the other hand, support *Essex Universal* and equate the twelve per cent, or even the 9.7, with a fifty-plus-per cent majority.

The court obviously chose the latter, supported, moreover, by the "actual transfer" distinction.

(3) *Mere-Incumbency Control*

Quite clearly, as in *Essex Universal* and *Caplan,* not even a smidgen of corporate democracy, either majority or otherwise, was present in *Republic.* In all three, control tenure was achieved by mere incumbency: (1) the wide dispersal of shares and (2) the proxy-solicitation system. True, each block of 28.3, 9.7, or twelve, and three per cent, "carried with it actual control"[150] but this control was not founded on the majority approval of corporate democracy but on the domination of the proxy statement by incumbent management. One could conjecture that subliminally Justice Korn knew full well this truth. In fact, so subtly is 9.7 per cent equated with a fifty-plus per cent majority, one forgets that the court is subscribing completely to the corporate democracy of *Essex Universal.* Further, the *Republic* opinion must be read in the light of *Essex Universal* and *Caplan,* else the conclusion would be irresistible that control tenure by mere incumbency was being accorded full legitimacy.

(4) *The Proximate Norms of Suitability*

If all the conjectures and subliminal holdings have been justified, the consequent and most logical imputation of all would be the last: that the *Republic* court *formally* based its opinion—apart from the transfer ploy—on a specious democratic majority, but *actually* founded the legitimacy of Zeckendorf's appointment on the acceptability of the Muscat-dominated B.S.F. for the control of Republic Corporation. Such conjecture would explain the remainder of the opinion.

[150] Ibid.

Although the court did not discuss directly the overall fiduciary duty of the *bonum commune* of the corporation, or the contrôleur's subobligation to select competent personnel, particularly his successor, the qualifications of B.S.F. for the job figured so prominently as to suggest that the conjectures were justified.

> [T]he petition and supporting affidavits are devoid of any showing of impropriety in the election of the individual respondents as directors of Republic . . . .[151]

Yet earlier the court had tacitly disavowed any concern with B.S.F.'s suitability:

> In their brief . . . petitioners state that "We are not trying in this action whether the respondents should be removed for cause, but solely whether their election on July 11, 1963, was legal, under the Caplan case."[152]

In spite of this disavowal, the *Republic* court went forward with this question of removal for cause, and the possibility of a breach of duty in appointing B.S.F.

(5) *Indicia of Breach*

The court was far from according a presumption of unsuitability to the presence of an unexplained (and hence presumptively, albeit rebuttably, illicit) premium, but in this particular Justice Korn joined the *Caplan* court in a realization that a premium pointed to something awry. He related such premium to an illicit transfer.

> Moreover, in [*Caplan*] . . . the price paid was one and one-half times the market value of the stock on which an option was acquired, and such fact clearly established that the "premium price was being paid for the accompanying transfer of managerial control that was the all important emolument of the transaction. In fact, what occurred here was the mere sale and purchase of naked directorial control, without any accompanying sale or transfer of control stock."[153]

With this groundwork, the *Republic* court distinguished the *Republic* facts from *Caplan* with a genuine and controlling distinction. Here, in fact, is the principal reason why the holding in *Republic* should and does go contra to *Caplan*. "Here, the purchase price was substantially the same as the market price; there was no premium paid for control . . . ."[154] Justice Korn could not be interpreted as reasserting the *Gabriel-Caplan* premium illegality, since no premium was present, but his emphatic averment of its absence bespeaks his estimate of its importance.

151 Id. col. 2.
152 Ibid.
153 Ibid.
154 Ibid.

The presumption of propriety, therefore, attendant on an appointment by a legitimate incumbent remained standing. Neither a presumption of premium illegality nor a consequent premium presumption of appointee unsuitability were present.

Throughout the opinion the *Republic* court adverted to lesser *indicia* of unsuitability. (1) The possibility of self-serving salary contracts. "It further appears that the directors have voted three of the new group salaries of $15,000 each . . . ."[155] Nothing reprehensible appears on the face of such action. Justice Korn correctly dropped the matter. (2) Stock options to the incoming contrôleur. The directors of Republic had voted options to the three principal Muscat men. This again, without more, would seem to invite no animadversion. (3) Prospective damage to the entity. Midway in its opinion the court cited this major indication of B.S.F.'s moral integrity:

> [T]he petition and supporting affidavits are devoid of any showing of . . . harm done to, or damage sustained by, the corporate respondent, the interests of which petitioners claim they are seeking to protect.[156]

Here was negative evidence that B.S.F. had at heart the best interests of the Republic Corporation.

The absence of the premium—and the consequent presumptions—and the absence of any lesser *indicia* of appointee unsuitability remove any last question of the legitimacy of the B.S.F. appointment. At least on the facts adduced.

(6) *The Adjudication*

Since William Zeckendorf, Sr., held unchallenged (hence presumptively legitimate) control of the Republic Corporation, his appointment of the B.S.F. Corporation to succeed himself enjoys a presumption of propriety, on the premise that an incumbent is performing his duties satisfactorily until proven otherwise.

The right to appoint in the beginning is founded on the legitimacy of the nondemocratic, mere-incumbency control tenure. In no wise did it depend on the specious equation of 9.7 or twelve per cent with a strict fifty-plus-per-cent democratic majority.

A countervailing presumption of impropriety did not arise, since no premium, at least on the record, passed from B.S.F. to Zeckendorf. The crux of the matter, therefore, became an inquiry into the general suitability of B.S.F.

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155 Id. cols. 1-2.
156 Id. col. 2.

On the assumption of complete facts in the opinion of special term, the appointment of the B.S.F. Corporation as the contrôleur of Republic Corporation was in all respects legitimate.

The absence of a premium essentially distinguishes *Republic* from both *Essex Universal* and *Caplan.*

The ad hoc analyses of *Essex Universal*, *Caplan-Lionel*, and *Republic* have thus elicited a rather substantial set of rules[157] which should go far toward dispelling "the doubts and questions" which disturbed the Second Circuit in *Essex Universal.* In each case the conclusion reached was correct, but to all three courts, it could be said with Thomas to the Tempters:

> The last temptation is the greatest treason:
> To do the right deed for the wrong reason.

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[157] For an instance of these rules in practical operation, see Bayne and Johnson, A Legitimate Sale of Control: The Weyenberg Shoe-Florsheim Case Study, — —— — (1965).